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IN FOCUS

May 16, 2016

Currency Exchange Rate Policies and the World Trade Organization Subsidies Agreement

Some Members of Congress have expressed concerns that foreign countries are "manipulating" their currencies through their exchange rate policies. Such concerns have focused on policies that are seen as weakening the value of the countries' currencies against the U.S. dollar. Some commentators have suggested that these practices amount to an export subsidy. They argue that although that subsidy may benefit U.S. consumers through lower prices, it may also harm U.S. import-competing firms and their workers.

Legislation introduced in the 114th Congress would amend Title VII of the Tariff Act of 1930, 19 U.S.C. §§1671 et seq., to treat an undervalued currency as an export subsidy under U.S. trade law; describe a methodology to determine how much the currency is undervalued (i.e., the subsidy); and apply that calculation for the imposition of countervailing duties (CVDs). *E.g.*, H.R. 820; S. 433. If enacted, such legislation could ultimately allow the U.S. Department of Commerce (DOC) to impose CVDs on certain injurious imports from foreign countries whose currencies had become undervalued as a result of government action.

Summary

This *In Focus* analyzes whether the United States could, consistent with World Trade Organization (WTO) subsidies rules in the Agreement on Subsidies and Countervailing Measures (ASCM) and the General Agreement on Tariffs and Trade 1994 (GATT), impose CVDs on imports from a WTO member country to offset what the U.S. determines is an illegal subsidy conferred by that member on its domestic industries through undervaluation of its exchange rate. This *In Focus* does not examine the consistency of exchange rate policies with other provisions of the WTO agreements.

As discussed below, it may be difficult to argue that currency exchange rate policies constitute a countervailable export subsidy as defined under WTO law. In particular, such monetary and fiscal policies do not clearly fit within ASCM provisions that define an export-contingent subsidy, as these provisions have been interpreted in dispute settlement cases.

The WTO's dispute settlement process would ultimately determine whether CVDs on imports from countries that are manipulating their exchange rates are consistent with WTO agreements. If the U.S. maintains CVDs on products in the absence of a countervailable "subsidy" as defined in WTO law, the WTO's Dispute Settlement Body (DSB) ultimately may authorize a complaining member to engage in trade retaliation. *See*, *e.g.*, ASCM Arts. 10, 32.1, 32.5. For example, the DSB could authorize a complaining member to raise tariffs on imports of U.S. products above its bound commitment levels.

For additional background on the debate over countries' exchange rate policies and a discussion of other international forums for addressing concerns with these policies, see CRS Report R43242, *Current Debates over Exchange Rates: Overview and Issues for Congress*, by Rebecca M. Nelson.

Can Currency Exchange Rate Policies Constitute a "Subsidy"?

Under WTO rules, the United States cannot impose CVDs on imports from a WTO member considered to be manipulating its currency exchange rate unless such practices provide a countervailable "subsidy" to that member's industry within the meaning of ASCM Article 1. This article states that a subsidy exists when a government or other "public body" makes a "financial contribution" within the territory of a WTO member that confers a "benefit." This analysis assumes that the financial contribution is made in the territory of a WTO member.

Government or "Public Body"

A subsidy may exist not only when a government makes a financial contribution, but also when another "public body" of a member makes such a contribution. The Appellate Body has held that determining whether an entity is a public body involves a fact-specific inquiry, but that generally such entities must possess, exercise, or be vested with governmental authority. *US—Anti-Dumping and Countervailing Duties (China)*, WT/DS379/AB/R, paras. 317-318.

Under WTO jurisprudence, the government need not delegate such authority explicitly to the entity in a law. If, in fact, a government has meaningful control over an entity and its conduct, this can serve as sufficient evidence that the entity exercises government authority when it performs a governmental function. However, mere "formal links" between the government and entity, such as a government's stake in the entity, are not sufficient by themselves. *Id.*

"Financial Contribution"

Not all government measures or practices that benefit a domestic producer or exporter constitute subsidies. The ASCM enumerates five general categories of measures or practices that are subsidies:

> (a)(1)(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or

... there is any form of income or price support in the sense of Article XVI of GATT.

None of the first four categories of financial contributions appears to cover government exchange rate policies. For example, category (i) includes government practices involving direct transfers of funds. To weaken its currency, a government might, for example, sell domestic currency in exchange for foreign currency or assets denominated in foreign currency in foreign exchange markets. However, such transactions, which involve a government's macroeconomic policies, appear to differ from the types of direct transfers of funds to private entities contemplated in this category (e.g., grants, loans, and equity infusions). It is also not clear that exchange rate policies are *direct* transfers of funds to producers and exporters because these entities' export earnings depend on demand by third parties in foreign markets for their products.

One might argue that a category (i) "financial contribution" exists when currency from export transactions is exchanged for an undervalued currency. *See, e.g.*, H.R. 820. However, it is not clear that a member's exchange rate policies could be imputed to such a transaction when analyzing whether it meets the other elements of a countervailable subsidy under WTO law. Exchange rate policies affect the entire economy rather than being directly targeted at exporters.

It could also be argued that exchange rate policies provide "income ... support" to producers or exporters. WTO adjudicators have not engaged in significant interpretation of this phrase, but a recent panel decision suggests it should be interpreted narrowly. Panel Report, *China-GOES*, ¶ 7.85, WT/DS414/R ("[I]t is not clear that [this provision] was intended to capture all manner of government measures that do not otherwise constitute a financial contribution, but may have an indirect effect on a market.").

"Benefit" Conferred

Assuming that exchange rate policies that lead to currency undervaluation could constitute a "financial contribution," a "subsidy" exists only when some "benefit" has been conferred on a member's exporters or producers. Here, the analysis focuses on the advantage to the recipient of the government financial contribution and whether it is received "on terms more favourable than those available to the recipient in the market." Appellate Body Report, *Canada—Aircraft*, WT/DS70/AB/R, paras. 157-158. Commentators have noted that establishing a "benefit" might be complicated by difficulties in linking the foreign exchange rate policies to increased sales and higher profits of exporters. *E.g.*, Claus D. Zimmerman, *Exchange Rate Misalignment and International Law,* 105 Am. J. Int'l L. 423, 449-451 (2011).

In addition, the member imposing CVDs might encounter difficulty in calculating the benefit conferred. *See* ASCM Art. 14. There is no universally used or accepted methodology for determining a currency's market value. Several methodologies are used by the International Monetary Fund and other organizations to make assessments of exchange rates. However, these produce widely different results. Any attempt to establish a CVD rate for affected imports could potentially be challenged by the affected country in the WTO as arbitrary.

Can Currency Exchange Rate Policies Confer a "Prohibited" Export Subsidy?

If a WTO panel held that exchange rate policies qualified as a "subsidy," then a WTO member could not impose CVDs on imports from a country that conferred such a subsidy unless the subsidy were "specific" under the ASCM. The ASCM defines four types of specificity: (1) enterprise; (2) industry; (3) regional; and (4) subsidies deemed specific because they are prohibited subsidies contingent upon export performance or the use of domestic over imported goods. ASCM Art. 2. If exchange rate manipulation were a "subsidy," it would arguably be broadly available to a wide variety of enterprises, industries, and regions in the subsidizing member's territory. Thus, commentators have focused on whether exchange rate policies could be "specific" because they are "prohibited" export subsidies (i.e., subsidies whose grant is at least partly contingent upon the export of goods).

Questions have been raised about whether a subsidy resulting from currency exchange rate policies would be "in fact tied to actual or anticipated exportation or export earnings." ASCM n.4. Some have argued that such policies may qualify even if they also grant a subsidy to firms that do not export, citing *U.S.—Tax Treatment for Foreign Sales Corporations (Article 21.5—EC)*, WT/DS108/AB/RW, paras. 119-120. However, even if this is a correct interpretation of precedent, it may still be difficult to argue successfully that an export-contingent subsidy exists. The fact that a government grants a subsidy to firms that export does not necessarily mean a sufficient "tie" between the subsidy and anticipated exportation exists. ASCM Art. 4; *Canada—Aircraft*, ¶ 171. The Appellate Body has held that existence of an export subsidy depends partly on "whether the granting authority imposed a condition based on export performance in providing the subsidy." *Id.* at ¶ 170. It is not clear that exchange rate policy "subsidies" would be contingent upon exports, as their grant appears conditioned upon the *exchange* of foreign currency for undervalued currency and not upon the *export* of products.

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